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CHARLES ELMORE CROPLEY

Supreme Court of the United States

OCTOBER TERM, 1949.

No. 505.

TRANSPORT, TRADING & TERMINAL CORPORATION,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

PETITION FOR REHEARING OF PETITION FOR WRIT OF CERTIORARI.

ARTHUR A. BALLANTINE,
CHARLES C. MACLEAN, JR.,
Counsel for Petitioner.

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To The Honorable, The Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Petitioner hereby petitions for a rehearing of its petition for a writ of certiorari in the above-entitled cause which was denied by this Court on February 13, 1950, and in support thereof respectfully shows:

I. On December 29, 1949, petitioner filed its petition praying that a writ of certiorari be issued to the United States Court of Appeals for the Second Circuit to review a judgment of that Court rendered on October 4, 1949,

reversing a decision of The Tax Court of the United States that the petitioner had overpaid its Federal income taxes for the calendar year 1940. The Tax Court held that the petitioner, Transport, Trading & Terminal Corporation, realized no gain upon the distribution which it made of certain shares of Pacific-Atlantic Steamship Corporation as a dividend in kind to petitioner's parent, American-Hawaiian Steamship Company, either by reason of the distribution itself or by reason of the subsequent sale of such shares by American-Hawaiian.

On January 9, 1950, this Court handed down its decision in *United States* v. *Cumberland Public Service Company* (No. 214, October Term, 1949). That case, like this, arose because a stockholder of a corporation sold property received from the corporation, and in each case the Commissioner asserted a corporate tax liability on the theory that the distribution to the stockholder should be disregarded because made in order to save a tax. This theory, which was accepted unreservedly by the court below in the present case, was squarely rejected by this Court in the *Cumberland* case. Notwithstanding the clear conflict of the decision below with this Court's decision in the *Cumberland* case, this Court has denied certiorari here.

In his brief in opposition, the Commissioner attempted to distinguish this case from the *Cumberland* case solely on the ground that in the *Cumberland* case the distribution was made in liquidation, whereas in the present case the distribution was made by the petitioner, as the Commissioner states, "while it was actively engaged in business." Since the two cases are otherwise indistinguishable, it is submitted that this Court was influenced, erroneously, by the Commissioner's insistence that dividends in kind paid in order to facilitate an anticipated sale of the property,

unlike distributions in liquidation made for such purpose, result in a tax upon the distributing corporation.

Since the filing of the briefs herein, the fallacy of the Commissioner's contention has been made perfectly clear by the Treasury's recent request to Congress for a change in the statutory provisions governing the tax consequences of intercorporate dividends in kind. This request was made by the Secretary of the Treasury in the course of his appearance as Chief Fiscal Officer of the Nation before the Ways and Means Committee of the House on February 3, 1950. In his statement, the Secretary characterized the present tax treatment of such dividends of property intended to be sold as a "loophole" which

> "has in the past enabled many corporations desiring to sell property to avoid income tax upon such transaction by first distributing the property in kind to a parent company."*

In a supplemental statement submitted by the Secretary to the Committee as Exhibit 4, the Secretary said:

> "One of the more troublesome problems under existing law involves distributions in kind made by corporations to their shareholders. A striking loophole in this area is presented in cases where such distributions are made by a subsidiary to its parent company. *No gain or loss is recognized to the subsidiary in such cases;* and the parent company is allowed an intercorporate dividend credit equal to 85 percent of the market value of the property so received. Moreover, the parent company takes the property at a new basis equal to its market value at the time of the distribution." (Italics added.)

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* Statement of Secretary Snyder on 1950 Revenue Bill before the House Ways and Means Committee February 3, 1950 (Treasury Department Press Release No. S-2238, p. 18).

These statements show that the Treasury recognizes that, to date, Congress has not imposed any tax on a subsidiary distributing dividends in kind to its parent even where, as the Secretary states, the distribution is made in order "to avoid income tax" upon a prospective sale of the property distributed. Notwithstanding the decision below, the Treasury attached no qualification to the statements so made to the Ways and Means Committee. The Treasury did not suggest that the result is different where the dividend serves no "business purpose" or is not a "dividend" within the meaning of §115(a) I. R. C.—the absurdities contrived by the court below, which the respondent shunned in his brief to this Court.

The Treasury's proposal to Congress is that the 85% dividends received credit (§26(b) I. R. C.) available to a parent corporation receiving such a dividend, should be computed upon the basis of the property in the hands of the subsidiary, rather than upon the fair market value of the property received by the parent, so that, as the Secretary stated (Exhibit 4, p. 7):

> "upon receipt of the property by the parent corporation a full tax would be paid by the parent upon the increase in value of the property distributed."

The Treasury's recommendations provide the answer to respondent's attempt to differentiate this case from the *Cumberland* case on the ground that here the dividend was not a distribution in liquidation but was paid by a "going concern". In short, the Treasury has acknowledged that Congress has drawn the same line between (1) sales by a subsidiary corporation and (2) *dividends in kind* for the purpose of sale, that this Court found in the *Cumberland* case to exist between (1) sales by a corporation and (2) *distributions in kind* made in liquidation for the purpose of sale.

It is scarcely conceivable, therefore, that the Solicitor General would have opposed the petition in this case if he had known of the Treasury's position, so clearly stated by the Secretary before the Ways and Means Committee, that a subsidiary corporation incurs no tax by reason of a dividend in kind paid to its parent for the purpose of avoiding a tax on a prospective sale of the distributed property.

II. For the reasons shown above, this case is indistinguishable, *as a matter of law,* from the *Cumberland* case. The patent conflict between the two cases would seem to have required a grant of the writ here unless the ground of distinction attempted to be drawn by the Commissioner, discussed above, has misled the Court. Otherwise, it would seem that the writ could only have been denied because the Court was distracted from the legal issues by the Commissioner's emphasis on the fact that, three years before the dividend in kind was paid, the petitioner had acquired the shares which were the subject of the dividend in kind in a transaction in which petitioner's parent, American-Hawaiian, sustained a loss which was allowed for income tax purposes.

This wholly irrelevant circumstance has been stressed by the Commissioner throughout the entire history of this litigation, first in the Tax Court (R. 5), then before the Court of Appeals (Commissioner's brief, p. 19), and finally in the Commissioner's brief in opposition here, where he said (Br., p. 11):

> "On the undeniable facts of the case, the Commissioner was warranted in concluding that as between these two members of an inter-corporate family, the gain was realized by the subsidiary. It will be noted that this very block of stock in the Pacific-Atlantic Company had been the subject of an inter-company transfer which occurred only three

> years previously—a transaction whereby the parent sold the stock to the taxpayer for $20,000, and as a result of which it claimed and was allowed a capital loss deduction of $480,000 in its tax return for 1937. (R. 5) It was this same stock which was again sold in the taxable year for $582,285." (R. 10)

The Commissioner has never asserted that the loss allowed to petitioner's parent was improperly allowed; he has merely implied that there was something colorable or sham in the public auction sale at which petitioner purchased the shares from its parent. If the Commissioner had affirmatively stated that he had erred in allowing the loss to petitioner's parent, then the Commissioner's effort in this proceeding would have been disclosed to be what it has been in fact—an attempt to recoup for the Government, through imposing a tax upon the petitioner, a tax benefit which the Commissioner now considers should not have been allowed to American-Hawaiian.

If, therefore, the Court has been influenced to deny the writ here because of the 1937 loss allowed to American-Hawaiian, the real issue before this Court becomes whether the decision below, erroneous on its face, should be permitted to stand so as to enable the Government to recoup from this taxpayer the tax benefit assumed to have been improperly conferred upon its parent.

When the issue is so unmasked, the decisions of this Court leave no doubt as to what the answer should be. Essentially the same problem was considered in *McEachern* v. *Rose*, 302 U. S. 56 (1937), where this Court held that the Government was precluded from denying refunds of overpayments admittedly owing to the taxpayer through the device of crediting such overpayments against a tax liability, collection of which was barred by the statute of limi-

tations. The Court considered that denial of the refunds would be a clear violation of the statute, stating (pp. 59-60):

> "* * * But Congress has set limits to the extent to which courts might otherwise go in curtailing a recovery of overpayments of taxes because of the taxpayer's failure to pay other taxes which might have been but were not assessed against him. Section 607 of the 1928 Act [§3770(a)(2) I. R. C.] declares that any payment of a tax after expiration of the period of limitation shall be considered an overpayment and directs that it be 'credited or refunded to the taxpayer if claim therefor is filed within the period of limitation for filing such claim'; and §609(a) of the 1928 Act [§3775(a) I R. C.] provides that 'Any credit against a liability in respect of any taxable year shall be void if any payment in respect of such liability would be considered an overpayment under section 607.' *These provisions preclude the Government from taking any benefit from the taxpayer's overpayment by crediting it against an unpaid tax whose collection has been barred by limitation.*" (Italics added.)

Clearly, therefore, under the statute, the tax liabilities of the current year are not to be influenced, much less determined, by the barred tax liability, if any, of a prior year. *A fortiori,* the tax consequences of a current transaction of the subsidiary should not be governed by a barred tax liability, if any, of its parent. Here, however, if the Court refuses to correct the decision below, solely because of the transaction of another taxpayer now closed by the statute of limitations, the Court will have sanctioned a clear violation of the Congressional design reflected in §§3770(a)(2) and 3775(a) of the Code.

The crude sort of recoupment which the Commissioner is attempting here was condemned by this Court in *Roth-*

ensies v. *Electric Storage Battery Co.*, 329 U. S. 296 (1946). In that case, this Court rejected the taxpayer's attempt to offset (under the doctrine of recoupment) the amount of certain illegally assessed excise taxes paid for the years 1919-1922, refund of which was barred, against the income tax liability attributable to refunds of illegally assessed excise taxes paid by the same taxpayer for the years 1922-1926. The sole basis of this Court's decision was that the attempted recoupment, if allowed, would undermine the statute of limitations. The Court said (pp. 301, 302, 303):

> "It probably would be all but intolerable, at least Congress has regarded it as ill-advised, to have an income tax system under which there never would come a day of final settlement and which required both the taxpayer and the Government to stand ready forever and a day to produce vouchers, prove events, establish values and recall details of all that goes into an income tax contest. Hence, a statute of limitation is an almost indispensable element of fairness as well as of practical administration of an income tax policy.
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> "As statutes of limitation are applied in the field of taxation, the taxpayer sometimes gets advantages and at other times the Government gets them. Both hardships to the taxpayers and losses to the revenues may be pointed out. They tempt the equity-minded judge to seek for ways of relief in individual cases.
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> "But if we should approve a doctrine of recoupment of the breadth here applied we would seriously undermine the statute of limitations in tax matters. * * *
>
> • • • • • •

> "We cannot approve such encroachments on the policy of the statute * * *."

If, because of the 1937 tax loss which is assumed but not asserted by the Commissioner to have been improperly allowed to American-Hawaiian, this Court declines to correct the erroneous decision of the court below imposing a tax on petitioner, then we respectfully submit this Court will have approved an encroachment on the policy of the statute of limitations far more flagrant than the encroachment which this Court so strongly condemned in the *Electric Storage* case.

III. On February 3, 1950, Secretary Snyder told the House Ways and Means Committee (p. 13):

> "We all know that the workability of our tax system and especially of the income tax depends on the high regard our people have for the fairness of our tax laws and their administration."

But if, at the same Term at which the Court granted review to the Government in the *Cumberland* case, this Court denies review to a taxpayer of a decision which is in square conflict with this Court's decision in the *Cumberland* case, then we submit, with all due respect, that such result will furnish a foundation for what some members of the public are already saying, viz., that whether this Court will review a tax case depends, not upon the importance or merit of the question presented, but upon whether the Government is the petitioner for review. Such a policy, we submit, would do much to shake the confidence of the people in the fairness of the administration of our tax laws.

For the foregoing reasons, it iis earnestly requested that a rehearing of the petition for ccertiorari herein should be granted.

Respectfully sulbmitted,

ARTHUR A. BALLANTINE,

CHARLES C. MACLEAN, JR.,
Counsel for Petitioner.

Certificate of Counsel.

We, ARTHUR A. BALLANTINE and CHARLES C. MACLEAN, JR., hereby certify, pursuant to Rule XXXIII(2), that the foregoing petition for rehearing iis presented in good faith and not for delay, and that the petition for rehearing is restricted to grounds of controlliing importance which have intervened since filing of the petition for writ of certiorari, and other substantial grounds available to petitioner but not previously presented.

ARTHUR A. BALLANTINE,

CHARLES C. MACLEAN, JR.

